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IN THE

Supreme Court of the United States.

OCTOBER TERM, 1932.

No. 283.

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

against

MURRY GUGGENHEIM,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF FOR THE RESPONDENT.

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The Evening Post Job Printing Office, Inc., 154 Fulton St., New York, N. Y.

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IN THE

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No. 283

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Petitioner,

AGAINST

MURRY GUGGENHEIM,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF FOR RESPONDENT.

Abstract of the Case.

This is a proceeding to review a decision of the Circuit Court of Appeals for the Second Circuit (R. 109), 58 F. (2d) 188, reversing a determination of the Board of Tax Appeals that there was a deficiency in the Respondent's 1925 gift tax of $2,430,544.02 (R. 104) (24 B. T. A. 1181) and holding that there was no deficiency.

In 1917 Murry Guggenheim, the Respondent, created two trusts, one for his son and one for his daughter. In each of these trusts he reserved a power of revocation.

In 1924 a new Revenue Law was passed imposing a tax upon "the transfer * * * by gift * * * of any property" with certain exemptions (Section 319, Revenue Act of 1924).

In 1925 the Respondent relinquished his powers of revocation.

The Commissioner of Internal Revenue assessed a tax upon this relinquishment as a transfer by gift of property (R. p. 8).

The ruling of the Commissioner was sustained by the Board of Tax Appeals (R. p. 92).

The decision of the Board of Tax Appeals was reversed by the Circuit Court of Appeals (R. p. 109).

The matter then came to this Court on certiorari under Section 240(a) of the Judicial Code as amended by the Act of February 13, 1925 (R. p. 116).

There is no disputed question of fact, all facts having been stipulated (R. pp. 10-17).

There is no constitutional question.

The only question in the case is one of the interpretation of the Statute. Are the words "the transfer * * * by gift * * * of any property" to be construed to include the surrender of these powers of revocation?

Summary of Argument.

The transfer of property in connection with these trusts could not have occurred both when the trusts were created and when the powers were extinguished. It occurred when the trusts were created. In 1924 when the act was passed and in 1925 when the powers were extinguished, it was the settled common law that the creation of a voluntary trust, though a power to revoke was reserved, operated as a transfer of property within the common law meaning of that term and passed legal title to the trustee and beneficial title to the *cestui que* trust (*infra*, pp. 8-11).

Conversely, it was settled common law in 1924 and 1925 that a power to revoke was not a property right, and that the extinguishment of such a power was not a transfer of property (*infra*, pp. 11-17).

A comparison of the gift tax section of the 1924 Revenue Act with the other sections of the Act shows that the words "transfer of property" in the gift tax section were not intended to include the extinguishment of powers. The contiguous sections 302(c) and 302(d) of the Act treat transfers of property in contemplation of death and the relinquishment of powers in contemplation of death in contra-distinction. The gift tax omits any language extending its operation to the relinquishment of powers, while the estate tax and income tax sections contain specific and elaborate language relating their operation to the relinquishment of powers (*infra*, pp. 17-19).

In 1924 and 1925, it was the law, and it still is the law and the settled administrative practice, that a donor who creates a revocable trust must pay a stock transfer tax on all shares of stock in the trust when the trust is set up, and, if a revocation later occurs, must pay another stock transfer tax as on a retransfer. The Government has never attempted to impose the stock transfer tax upon the surrender of a power to revoke (*infra*, pp. 19-20).

Taxing statutes in a common law country should be construed strictly against the government and literally in accordance with the common law meaning of their terms (pp. 20-21).

There were in 1924 and 1925 no decisions challenging the rules above set forth. The sole authority against them was a ruling of the Bureau of Internal Revenue under the

gift tax section of the 1924 Act. The Bureau had previously made similar rulings in regard to the estate and income taxes and had reversed them on argument (*infra*, pp. 21-22).

Nothing has happened since 1925 to justify a retroactive change in the old law.

The repetition of the language of the 1924 gift tax in the 1926 Revenue Act was not a legislative approval of the Commissioner's regulation applying the gift tax to the relinquishment of powers, for that repetition was for the purpose of limiting and repealing the older act, and because it lacked all the other elements needed for an inferred legislative approval (*infra*, pp. 23-25).

The cases decided in this court since 1925 in regard to the constitutional power to tax the extinguishment of powers are not in point. They deal with a different question and apply a diametrically opposed rule of presumption (*infra*, pp. 25-33).

The Petitioner's argument that there must have been an implied holding that the extinguishment of the powers in such cases were "transfers of property" at the time of death when the powers were extinguished because the "estate tax" can only be imposed where there is a strict transfer of property at the time of death, is unfounded (*infra*, p. 36).

The recent opinion in *Tyler* v. *United States*, 281 U. S. 497, clearly summarizes the law both on the interpretation of the phrase "transfer of property" and on the constitutional power of Congress to tax the extinguishment of powers. The Respondent stands squarely on the statement of the law set forth in this case (*infra*, pp. 34-36).

To change by retroactive decision the common law meaning of the words used in the 1924 gift tax after taxpayers have acted in reliance on the old meaning would be unjust.

ARGUMENT.

The Creation of the Deeds of Trust.

In 1917 the Respondent, Murry Guggenheim, created two trusts, one for his son and one for his daughter (R. p. 11). The securities were at once transferred to the Commercial Trust Company of New Jersey and Clarence L. Meyers as trustees, and have been held ever since in the trusts. The beneficiaries under the trusts began at once to enjoy the distributable income and have continued in that enjoyment ever since (R. Exs. 2 and 15, pp. 20 and 58). Each trust deed reserved to the donor a power to alter and to revoke except as to accumulated income.

It was customary at that time to insert powers of amendment and revocation in family settlements.

In *Coutts* v. *Acworth*, L. R. 8 Eq. 558 (1869), the Vice-Chancellor said of a family settlement:

> "In my opinion, the fact of there being no such power of revocation is all but a conclusive reason for setting aside the deed. * * *"

This Court said in *Jones* v. *Clifton*, 101 U. S. 225 (1879):

> "the absence of a power of revocation and of appointment to other uses in a deed of family settlement has often been considered a badge of fraud."

Careful practitioners therefore inserted such powers of revocation in all family trusts as a matter of course.

The donor never exercised his powers of revocation as to any portion of either of the trust funds. He never received any income under either of the trusts. He was a man of large property. He had made no other provision for his son and daughter. There is no reason to believe that he ever meant to use the powers of revocation for the purpose of continuing in enjoyment of the property in fact while appearing not to. We are dealing with the effect of a customary technical power of revocation uncomplicated by any extraneous circumstances.

The Revenue Act of 1924.

Before the passage of the Revenue Act of 1924 it had been settled in the Bureau of Internal Revenue that the income of a revocable trust was not taxable to the donor (L. O. 1102, I-2 C. B. 50 (1922)). But the act of 1924 changed this. Section 219(g) of that act provided:

> "Where the grantor of a trust has, at any time during the taxable year, either alone or in conjunction with any person not a beneficiary of the trust, the power to revest in himself title to any part of the corpus of the trust, then the income of such part of the trust for such taxable year shall be included in computing the net income of the grantor."

The Respondent therefore found himself threatened with an income tax amounting under the schedules of the 1924 law to 46% on every dollar of taxable income arising under the two trusts, income which he never received, income

arising from property which he had long ago alienated and which he had no intention of recovering, all because there had been inserted by counsel in the deeds of trust the standard power of revocation. But this is not all.

Section 319 of the same act of 1924 provided:

> "For the calendar year 1924 and each calendar year thereafter, a tax equal to the sum of the following is hereby imposed upon the transfer by a resident by gift during such calendar year of any property wherever situated, whether made directly or indirectly, and upon the transfer by a non-resident by gift during such calendar year of any property situated within the United States, whether made directly or indirectly; * * *."

Under this, the Commissioner of Internal Revenue ruled that all instalments of income paid by trustees to beneficiaries while a power to revoke existed would be taxed as gifts (Article 1, Regulations 67). Under this ruling, the donor was threatened with a gift tax on every dollar of income received by the beneficiaries of these trusts. It was an intolerable situation.

The Respondent was entitled to consult counsel as to whether he could not surrender the unfortunate and useless power of revocation, without subjecting himself to a gift tax upon the principal of the two trusts, and counsel were bound to advise, and the Respondent was entitled to act, on the basis of the statutes and decisions as they then stood.

The State of the Law in 1924 and 1925.

Anyone making a full study of the law in 1924 and 1925 would have found the following condition:

FIRST: It was well established that the retention of the customary power to revoke did not impair the validity of a trust nor interfere with the passage of legal title to the trustee and of equitable title to the beneficiaries.

In *Jones* v. *Clifton*, 101 U. S. 225 (1879), this Court had said:

> "The powers of revocation and appointment to other uses reserved to the husband in the deeds in question do not impair their validity or their efficiency in transferring the estate to the wife. * * *"
>
> "The title to the land and policies passed by the deeds; a power only was reserved. That power is not an interest in the property which can be transferred to another, or sold on execution, or devised by will."

In *National Newark & Essex Banking Co.* v. *Rosahl*, 97 N. J. Eq. 74 (1925), the Court said:

> "The trust was completely executed. The property passed out of the donor and vested in the trustee to the beneficial use of the *cestuis que trustent*. * * * If the power of revocation is not exercised, the interest remains vested as though such power had not been reserved. * * * The power is personal to the trustor. * * * The reservation of such power is not inconsistent with the passing of title to the property to the trustee. * * * The omission of such reservation has led to voluntary settlements being set aside on the ground of mistake."

In *Allen* v. *Hendrick*, 104 Oregon 202 (1922), the Supreme Court of Oregon said:

> "Reservation of the right of revocation does not affect the legal title of the property, for that passes and remains vested for the purposes of the trust, notwithstanding the existence of a right to revoke it."

In *Stone* v. *Hackett*, 12 Gray (Mass.) 227 (1858), the Court said:

> "A power of revocation is perfectly consistent with the creation of a valid trust. It does not in any degree affect the legal title to the property. That passes to the donee and remains vested for the purposes of the trust, notwithstanding the existence of a right to revoke it."

In *Van Cott* v. *Prentice*, 104 N. Y. 45 (1887), the Court said:

> "Neither the power of revocation nor the provision, determining the trust in the event of a legal interference, or the death of the trustee in the life of the settlor, are in the least inconsistent with the trust as completely and perfectly constituted. They both assume its separate and effective existence, and provide merely for its termination upon the happening of specified contingent events."

In *New York Life Insurance & Trust Company* v. *Cary*, 191 N. Y. 33 (1908), the Court said:

> "Whatever may have been accomplished by the trust deed was accomplished immediately upon its delivery to the trustee, accompanied by a transfer of the property therein mentioned. All the rights that Nellie Bostwick Morrell ever acquired in the trust fund she

acquired at that moment. There was no postponement of the enjoyment of those rights until the death of Mr. Bostwick. * * * It has been expressly decided by this Court more than once that the presence of a full power of revocation in an instrument of this character does not render it testamentary."

In *Dickerson's Appeal*, 115 Pa. 198 (1887), the Court said:

"A reserved right of revocation is not inconsistent with the creation of a valid trust. If the right is not exercised during the lifetime of the donor, * * * the validity of the trust remains unaffected, as though there never had been a reserved right of revocation."

In *Windolph* v. *Girard Trust Company*, 245 Pa. 349 (1914), the Court said:

"It is equally well settled that a reserved right of revocation is not inconsistent with the creation of a valid trust."

In *Nichols* v. *Emery*, 109 Cal. 323 (1895), the Court said:

"Nor did the fact that the settlor reserved the power to revoke the trust operate to destroy it, or change its character. He had the right to make the reservation (Civil Code, Section 2280) but the trust remained operative and absolute until the right was exercised in proper mode. *Stone* v. *Hackett*, 12 Gray, 232; *Van Cott* v. *Prentice*, 104 N. Y. 45. Indeed this power of reservation was strongly favored in the case of voluntary settlements at common law, and such trust, without such a reservation, was open to suspicion of undue advantage taken of the settlor * * *"

The same rule still prevails. In *Cramer* v. *Hartford Connecticut Trust Company*, 110 Conn. 22 (1929), the Court said:

> "We have then an instrument under the terms of which the property in question was transferred to a trustee and which created an immediately enjoyable life estate in the settlor and a present vested interest in those named to take at her death, defeasible only in the event that she exercised a reserved power of revocation. *With a striking unanimity of opinion such trusts have been held valid.*" (Italics ours.)

The Petitioner has tried in Point IV of his brief to oppose to these cases a line of decisions to the effect that a gift *inter vivos* at common law could not pass title if there was a power to revoke. That is true of strict gifts *inter vivos*. It is not true of the donative trust nor of the gift *causa mortis*. The argument is based on a confusion of elementary common law rules.

SECOND: It was also settled that a power was not itself property.

> "No two ideas can well be more distinct the one from the other than those of 'property' and 'power' * * * A 'power' is an individual personal capacity of the donee of the power to do some thing. That it may result in property becoming vested in him is immaterial; the general nature of the power does not make it property. The power of a person to appoint an estate to himself is, in my judgment, no more is 'property' than the power to write a book or to sing a song." *Ex parte Gilchrist*, 17 Q. B. D. 521 (1886).

This Court said of such a power in *Jones* v. *Clifton*, 101 U. S. 225,

"That power is not an interest in the property * * *."

In *People* v. *Kaiser*, 306 Ill. 313 (1922), the Court said:

"A power of appointment is not an absolute right of property, nor is it an estate, for it has none of the elements of an estate."

In *Melton* v. *Camp*, 121 Ga. 693 (1905), the Court said:

"A power is not property but a mere authority."

The same rule still prevails. It was summarized in *Farmers Loan & Trust Co.* v. *Bowers*, 29 F. (2d) 14 (1928):

"A power to revoke is not a property right, nor an interest in property. *Jones* v. *Clifton*, 101 U. S. 225, 25 L. Ed. 908; *Hill* v. *Nichols* (D. C.) 18 F. (2d) 139; *Reinecke* v. *Northern Trust Co.* (C. C. A.), 24 F. (2d) 91; *In re Dolan's Estate*, 279 Pa. 582, 124 A. 176, 49 A. L. R., 858; *Stone* v. *Hackett*, 12 Gray (Mass.) 227. The power of revocation is perfectly consistent with the creation of a valid trust. Title passes to the donee, and remains vested for the purpose of the trust, even though there may be a right to revoke it."

THIRD: There were two cases in State Courts squarely holding that the extinguishment of a power did not work a transfer of property.

In re Dolan's Estate, 279 Pa. 582 (1924), the Court said:

> "But the right to revoke, unexercised, is a dead thing. Its presence in a deed does not alter the character of the instrument or estate granted; to all intents and purposes, title and possession passed just as effectively as any deed or grant could make it, continuing in that state so long as the power of revocation lies dormant. * * * How then could the extinguishment of the power to revoke the deed of trust by the death of Mrs. Dolan—that is all death accomplished—work a transfer of property? The right of revocation, standing alone, is not tantamount to a property right in the settlor; it possesses none of the attributes of property. Mrs. Dolan did everything possible in 1908 to divest herself of the specific property. When she died in 1920, there was nothing left for her, the law, or any one to do to complete the act. Revocation is neither an estate nor property and cannot pass at death."

In re Hall's Estate, 99 N. J. L. 1, (1923), Francis Hall had made a deed of a business, including the good will, but had reserved the right to retake the good will *without payment*. An attempt was made to tax the extinguishment of this right as a transfer of property. The Court said:

> "But, assuming this view to be unsound, a mere right to acquire the good will of a business, which may be exercised or not at the option of the holder of that right, is not the equivalent of the ownership of the good will. Good will is property. An option to acquire it, if the holder of the option sees fit to exercise it, does not vest in him any ownership of the property itself or of any interest therein. The failure to exer-

> cise that option, or its relinquishment, by the holder transfers nothing to the persons who held the property which was the subject of the option. It merely wipes out the possibility that they may in the future be deprived of their ownership by the exercise of that option. For this reason I conclude that the surrender by Mr. Hall of his right to acquire the good will of this business (assuming that he had such right) did not justify the imposition of a tax upon that surrender, for the reason that section 1 of our Inheritance Tax Law, as amended in 1914, limits the imposition of an inheritance tax to 'the transfer of any property, real or personal * * * or of any interest therein or income therefrom.'"

This opinion in the Supreme Court of New Jersey was affirmed in the Court of Errors and Appeals expressly on the reasoning of the Court below:

> "PER CURIAM. The judgment under review herein should be affirmed for the reasons expressed in the opinion delivered by Chief Justice Gummere in the Supreme Court" (100 N. J. L. 405).

FOURTH: There was one case in this Court so close as to be fairly considered a controlling authority—*United States* v. *Field*, 255 U. S. 257 (1921).

In 1914 Joseph N. Field died leaving property to trustees to pay the income to his wife Kate for life, and after her death to pay the income of one-half of the fund to such persons as she should by will appoint. Kate Field died in 1917 leaving a will appointing this income to her children. The Commissioner included in the gross estate of Mrs. Field the property covered by the power of appointment.

Section 201 of the Act of 1916 imposed a tax upon the transfer of the net estate of every decedent dying after the passage of the act.

Section 202 provided:

> "Sec. 202. That the value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated:
>
> (a) To the extent of the interest therein of the decedent at the time of his death which after his death is subject to the payment of the charges against his estate and the expenses of its administration and is subject to distribution as part of his estate.
>
> (b) To the extent of any interest therein of which the decedent has at any time made a transfer, or with respect to which he has created a trust, in contemplation of or intended to take effect in possession or enjoyment at or after his death, except in case of a bona fide sale for a fair consideration in money or money's worth * * *".

There was no specific provision in the Act applying to the exercise of powers of appointment. That provision appeared for the first time in the 1918 Act (Section 402[e]).

The action of the Commissioner was contested and the matter came to this Court. No constitutional question was raised. The only point dealt with was the interpretation of the act. The Government argued that

> "A popular interpretation would include in the estate of a deceased testatrix property over which she enjoyed substantially all the incidents of ownership and of which she disposed at death."

The Court said:

> "No question being suggested as to the power of Congress to impose a tax upon the passing of property under testamentary execution of a power of appointment created before but executed after the passage of the taxing act (see *Chanler* v. *Kelsey*, 205 U. S. 466, 473, 478-479; *Knowlton* v. *Moore*, 178 U. S. 41, 56-61), the case involves merely a question of the construction of the Act. Applying the accepted canon that the provisions of such acts are not to be extended by implication (*Gould* v. *Gould*, 245 U. S. 151, 153), we are constrained to the view—notwithstanding the administrative construction adopted by the Treasury Deparment—that the Revenue Act of 1916 did not impose an estate tax upon property passing under a testamentary execution of a general power of appointment. * * * It follows that the interest in question, *not having been property of Mrs. Field* at the time of her death, nor subject to distribution as part of her estate, was not taxable under clause (a).
>
> We deem it equally clear that it was not within clause (b). That clause is the complement of (a), and is aptly descriptive of a transfer of an interest in decedent's *own property* in his lifetime, intended to take effect at or after his death. It cannot, without undue laxity of construction, be made to cover a transfer resulting from a testamentary execution by decedent of a power of appointment over *property not his own.*" (Italics ours.)

If the property had belonged to Mrs. Field, and if the exercise of her power of appointment had been a "transfer", it would, of course, have been a "transfer" intended to take effect, and for that matter actually taking effect, at death, and would have fallen within Section 202(b) of the Act.

Observe how closely the question decided resembles that in our own case.

There is a strong similarity between a general power of appointment and a power of revocation. They have been held equivalent for tax purposes. (*Farmers Loan & Trust Company* v. *Bowers*, 29 F. (2d) 14, at page 18; *Saltonstall* v. *Saltonstall*, 276 U. S. 260, at pages 269-270.) Mrs. Field had much the same substantial economic relation to the property covered by her power of appointment that a holder of a power to revoke has. She enjoyed the interest during her life and could appoint the property to whomsoever she chose upon her death. She could have assigned her life interest and appointed to the assignee by will, and could have coupled the appointment with a contract binding upon her estate. At the instant before her death she had, not quite, but, almost the substantial economic powers in relation to the property enjoyed by an absolute owner in fee. At the instant after her death she had none of these powers and the complete ownership and enjoyment was in the appointees. And yet the Court holds that because she did not have title, because she did not in the common law sense, own the property, there was no "transfer" from her to the appointees. The only substantial difference between the *Field* case and our own, is the difference, if any, between the degree of economic control over the property enjoyed by a holder of a power of revocation and by a holder of a life interest plus a general power of appointment.

FIFTH: A comparison of the gift tax section of the 1924 Act with the estate and income tax sections strongly indicated that the gift tax section was not intended to apply to the surrender of powers.

Section 302(c) of the Act of 1924 required the inclusion in the gross estate of property transferred in contemplation of death, and Section 302(d) required the inclusion of property subject to a power of revocation relinquished in contemplation of death. The later provision would have been sheer surplusage if the relinquishment was a transfer. If the relinquishment was a transfer it was covered by Section 302(c).

Moreover, Congress had inserted for the first time in the 1924 Act, in connection with the estate tax, a provision (Section 302(d)) that there should be included in the gross estate all property

> "To the extent of any interest therein of which the decedent has at any time made a transfer, or with respect to which he has at any time created a trust, where the enjoyment thereof was subject at the date of his death to *any change through the exercise of a power*, either by the decedent alone or in conjunction with any person, *to alter, amend, or revoke*, or where the decedent relinquished any such power in contemplation of his death, except in case of a bona fide sale for a fair consideration in money or money's worth;" (Italics ours)

In other words, Congress in the Revenue Act of 1924 for the first time specifically provided that trust property subject to a power of revocation should be included in the gross estate of a decedent, that is to say, treated as though it had been transferred on the extinction of the power, and Congress in the gift tax sections of the *same* statute completely omitted any such provision.

Turning to the income tax provisions of the Revenue

Act of 1924, we find appearing for the first time the following:

> "Section 219(g). Where the grantor of a trust has, at any time during the taxable year, either alone or in conjunction with any person not a beneficiary of the trust, the power to revest in himself title to any part of the corpus of the trust, then the income of such part of the trust for such taxable year shall be included in computing the net income of the grantor."

In other words, the Act of 1924 for the first time provided that for income tax purposes a revocable trust should be treated as though the transfer of the trust property did not take place until the extinction of the power of revocation, and, as we have said before, Congress entirely omitted any such provision in the gift tax sections of the act.

There is on the face of the statute the clearest indication that Congress knew the old rule that the extinction of a power was not a transfer of property, that Congress well knew how by appropriate, specific and effective language, to change that rule when it so desired, that Congress did desire to change that rule in the case of the income tax and the estate tax, and did so change it, that Congress did *not* desire to change the rule in the case of the gift tax and did not change it in the case of that tax.

Congress might have applied the gift tax to the extinguishment of a power of revocation *but it did not do so.*

SIXTH: In 1924 and 1925, it was the law, and it still is the law and the settled administrative practice, that a donor who creates a revocable trust must pay a stock transfer tax on all shares of stock in the trust when the

trust is set up, and, if a revocation later occurs, must pay another stock transfer tax as on a retransfer. Schedule A-3, Section 807, Revenue Act of 1924; Section 723, Revenue of 1932. The Government has never attempted to impose the stock transfer tax upon the surrender of a power to revoke.

SEVENTH: It was a settled rule of the common law that tax statutes were to be construed strictly and according to the common law meaning of their terms.

The recognized general principle was applied and stated by this Court in *United States* v. *Merriam*, 263 U. S. 179 (1923), the Court saying (pp. 187-188):

> "The word 'bequest' having the judicially settled meaning which we have stated, we must presume it was used in that sense by Congress. *Kepner* v. *United States*, 195 U. S. 100, 124; *The Abbotsford*, 98 U. S. 440, 444.
>
> "On behalf of the Government it is urged that taxation is a practical matter and concerns itself with the substance of the thing upon which the tax is imposed rather than with legal forms or expressions. But in statutes levying taxes the literal meaning of the words employed is most important for such statutes are not to be extended by implication beyond the clear import of the language used. If the words are doubtful, the doubt must be resolved against the Government and in favor of the taxpayer. *Gould* v. *Gould*, 245 U. S. 151, 153. The rule is stated by Lord Cairns in *Partington* v. *Attorney General*, L. R. 4 H. L. 100, 122."

For the sake of brevity we omit a general citation of authority on this point. The rule was unquestioned. It

had been stated and applied a hundred times in the Federal Courts.

Nor has there been any relaxation in this principle of construction since 1925. It was applied with exact severity in the recent case of *Crooks* v. *Harrelson*, 282 U. S. 55 (1930), where the Court excluded from a decedent's gross estate realty in Missouri an account of a peculiarity of local law exempting realty from liability for administration expenses. The Court said:

> "Finally, the fact must not be overlooked that we are here concerned with a taxing act, with regard to which the general rule requiring adherence to the letter applies with peculiar strictness."

EIGHTH: There was in 1924 and 1925 no decision and no language of any court at variance in any way with the indications above set forth.*

The sole inconsistent authority was a ruling of the Bureau of Internal Revenue (Article 1, Regulations 67) promulgated after the 1924 Act, to the effect that the creation of a revocable trust was not a gift, but that a gift occurred upon the termination of the power.

The Bureau of Internal Revenue had twice before made rulings based on the theory that a transfer occurred on the surrender of a power of revocation and had, in each case,

* The Petitioner claims that *Bullen* v. *Wisconsin*, 240 U. S. 625 (1916), was contrary to the conclusions reached above. He is in error. The trust deed in that case was a peculiar one. It provided "During my life time the *principal* and income shall be used for such beneficiaries and in such manner as I *may from time to time appoint*". The Supreme Court of Wisconsin held that under this trust "an inheritance tax was due in respect of the whole fund as upon a transfer intended to *take effect in enjoyment* after the donor's death" —All this court did was to hold that this action did not violate the Fourteenth Amendment.

reversed its ruling after argument. The Bureau had ruled the income of a revocable trust must be taxed to the donor (Par. 194, Reg. 33 (rev.) Art. 341, Reg. 45), this in 1918 before any special provision was inserted in the Income Tax Law requiring such a result, and the Bureau had rescinded this ruling upon argument saying "* * * the extinction of the possibility of a divesting did not result in the vesting of any new right. The right of revocation became extinct, but no property right passed to any one" (see Art. 341, Reg. 62 [1921]; L. O. 1102, I-2 C. B. 50 [1922]). The Bureau ruled under the Estate Tax in 1919, before any special provision was inserted in the statute, that property in a revocable trust should be included in the donor's estate at death (Art. 25, Reg. 37; and Art. 21, Reg. 63). This ruling the Bureau rescinded after argument in 1923 (T. D. 3487, II-1 C. B. 303). Just prior to the Act of 1924 the Bureau of Internal Revenue itself did not believe that the extinction of a power to revoke was a transfer of property.

Could any court on that state of law have said that the surrender of a power of revocation was *clearly and without question* a "transfer * * * of * * * property" and therefore, under the rule of construction, taxable within the gift tax section? We think not.

The Surrender of the Powers of Revocation.

In 1925 the Respondent did take advice of counsel, was advised that the surrender of the powers of revocation would not constitute a transfer of property, and did surrender the powers under both trusts.

The Authorities Since 1925.

Has anything happened since the year 1925 when the powers of revocation were extinguished to change the state of the law?

There have been two decisions on our point under the gift tax section of the Revenue Act of 1924. The first of these decisions was that of the Court of Claims in *Means* v. *United States*, 39 F. (2d) 748 (1930). That decision is squarely against us. The other is the decision of the Circuit Court of Appeals in the case at bar. That decision is in our favor.

The Petitioner claims that the later repetition in the 1926 Act of the words of the old 1924 gift tax section was a legislative approval of the regulation under which the tax was imposed, and had the effect of making the regulation retroactively valid even though it was invalid at the time when it was promulgated. The cases do not bear out this unreasonable position. In *Iselin* v. *United States*, 270 U. S. 245, the Court said at page 251:

> "The Government calls attention to the fact that, as early as October 24, 1919, the Commissioner of Internal Revenue made the ruling pursuant to which the

tax here in question was assessed; that on March 22, 1920, the Attorney General sustained that ruling; that the provisions here in question were re-enacted without substantial change in the Revenue Act of 1921, Act of November 23, 1921, § 800(a), c. 136, 42 Stat. 227, and the Revenue Act of 1924, Act of June 2, 1924 § 500(a), c. 234, 43 Stat. 253; and that the administrative practice adopted in 1919 has been steadfastly pursued. It suggests that these facts imply legislative recognition and approval of the executive construction of the statute. But the construction was neither uniform, general, nor long-continued; neither is the statute ambiguous. Such departmental construction cannot be given the force and effect of law. Compare *United States* v. *Falk & Brother*, 204 U. S. 143; *National Lead Co.* v. *United States*, 252 U. S. 140, 146."

The presumption is one the strength of which depends upon the circumstances. The repetition of the language of the 1924 gift tax section in the 1926 Act was for the purpose of lowering the rates of tax on gifts already made and for the purpose of repealing and abolishing the gift tax for the future. Any inference that by such a repetition of language Congress intended to extend the meaning of the Act as originally passed is very faint.

Congress has recently reimposed the gift tax, but has changed it by inserting a section making the tax payable, not only on strict transfers of property as under the old act, but, also on the relinquishment of powers to revoke. Section 501, Revenue Act of 1932. Under the dictum of this Court at the end of the *Field* case, above cited, a presumption would arise from this that the

Congress did not intend to have the earlier form of the gift tax apply to powers to revoke. But, here again the presumption is not a conclusive one. It should be enough, however, to destroy any effect of the argument based on the earlier re-enactment without change.

There have been five cases in this Court which are cited by the Government and which merit careful consideration.[1]

Let us consider these cases seriatim.

First

Saltonstall v. *Saltonstall*, 276 U. S. 260 (1928).

In 1905 Peter C. Brooks, in Massachusetts, created two trusts reserving the income for life and a power to revoke with the concurrence of one trustee. Thereafter the legislature of Massachusetts passed an act providing that the failure to exercise a power of appointment should be taxable under the statute taxing inheritances. The words of the statute were:

> "Whenever any person possessing such a power of appointment so derived shall omit or fail to exercise the same within the time provided therefor in whole or in part, a disposition of property taxable under the provisions of Chapter 563 of the acts of the year 1907 and all acts in amendment thereof and in addition thereto, shall be deemed to take place to the extent of such omission or failure."

[1] *Poe* v. *Seaborn*, 282 U. S. 101, was also cited. It has no bearing on our point. It held that California could not tax a husband on the entire income of community property in spite of his broad powers of control.

Mr. Brooks died after the passage of this act without revoking the trusts. A tax having been levied the State Court held

> "that the provisions of the trust instrument for change or termination of the trust by Peter C. Brooks with the consent of one trustee created a power of appointment * * *."

and sustained the tax. The taxpayer appealed to the Supreme Court of the United States on constitutional grounds. This Court had before it no question of the construction of the state statute. It recited the holding of the Massachusetts courts to the effect that the right of revocation was equivalent to a power of appointment and, following the usual rule for the interpretation of state statutes already construed by the local courts, said:

> "This construction of the statutes by the state court we accept."

The only question before this Court was a constitutional one. In the words of the Court:

> "we consider only the single objection discussed as a federal question by that court in its opinion, viz., that the statutes as applied deprive plaintiffs in error of their property without due process of law because retroactive as to them."

The Court went on to say on page 271 that the statute was not retroactive and unconstitutional because something did occur on the extinguishment of the right of revocation which might be made the subject of a tax, that "A power of appointment reserved by the donor leaves the transfer, as to him, incomplete and subject to tax."

The Court ends its opinion by saying:

> "we need not go further than to say that the statute of 1909, imposing the tax because of the failure to exercise the power of appointment, does not deprive plaintiffs in error of their property without due process of law."

The opinion in the *Saltonstall* case contains language which taken out of its context might help the Petitioner, but we must remember that this Court in the *Saltonstall* case was not deciding whether the words "transfer of property" as used in a tax statute clearly included the extinguishment of a power to revoke. The Massachusetts courts had already decided that the general power to revoke was a power of appointment, and the statute expressly and clearly taxed the extinguishment of such a power. All this Court did was to say that such an act was not so unreasonable as to deprive the plaintiff of his property without due process of law. The only thing which the court had to hold was that the extinguishment of the power was something on which the Legislature *could impose an excise tax.*

Not only was the Court determining a question quite different from the one involved in our own case, but it was applying a diametrically opposite rule of presumption. The Court is bound in *construing* a tax statute to take every intendment in favor of the taxpayer, but once the act has been so drafted as to clearly apply, then the Court must take every intendment in favor of its constitutionality.

> "Every presumption is to be indulged in favor of the validity of the statute."
>
> (*Graves* v. *Minnesota*, 272 U. S. 425.)

Second.

Chase National Bank v. *United States*, 278 U. S. 327 (1929)

Herbert W. Brown was the holder of three insurance policies on his own life. Each policy named his wife as beneficiary and each reserved to Mr. Brown the right of changing the beneficiary. These policies were all taken out on September 13, 1922, after the effective date of the Revenue Act of 1921. In April, 1924 Mr. Brown died, having made no change in the beneficiary of the policies. The Commissioner included the amount of the policies, less the statutory exemption, in the gross estate. Suit was brought in the Court of Claims, which certified the following questions:

> "Question I: Whether the tax imposed by the final clause of section 402(f), Revenue Act of 1921, 42 Stat. 278, on life insurance policies payable in terms to beneficiaries 'other than the decedent or his estate' is a direct tax on property and void because not apportioned.
>
> "Question II. Whether the $9,146.76 tax imposed bears such an unreasonable relation to the subject matter of the tax as to render it void."

Section 402 of the Revenue Act of 1921 provided that there should be included in the gross estate of the decedent all property:

> "(f) To the extent of the amount receivable by the executor as insurance under policies taken out by the decedent upon his own life; and to the extent of the

> excess over $40,000 of the amount receivable by all other beneficiaries as insurance under policies taken out by the decedent upon his own life."

The Court said:

> "In the present case there is no question of the construction of the statute. The tax is plainly imposed by the explicit language of §§ 401 and 402(f) if those sections are constitutionally applied."

The Court held that the tax was not a direct tax, and, then, dealing with Question II, decided that the extinction by death of the power to change beneficiaries was constitutionally capable of being taxed. The Court said:

> "* * * The precise question presented is whether the termination at death of that power and the consequent passing to the designated beneficiaries of all rights under the policies freed of the possibility of its exercise may be the legitimate subject of a transfer tax, * * *."

In coming to its conclusion the Court used language which, taken out of the context, might be helpful to the Petitioner in our case. The Court spoke of the termination of the right to change beneficiaries as "no less a transfer within the reach of the taxing power than a transfer effected in other ways through death". But we must remember that the Court was dealing with a statute specifically providing (Revenue Act of 1921, § 402(f)) that there should be included in the gross estate insurance in excess of $40,000 under policies taken out by the decedent in favor of others. The act by special definition and for *estate tax* purposes treats the extinction of the right to change beneficiaries as though it were a transfer of part of the net estate. There

could be no question of construction. The words of the statute applied with absolute clearness. The only question was one of constitutionality. To support the statute the court had only to hold that the termination of the right to change beneficiaries was a thing which the Congress could constitutionally tax. It did not have to hold, and did not hold, that the extinction of the power would have fallen within the term "transfer of property" if used in a taxing act without further elaboration.

Third.

Reinecke v. *Northern Trust Company*, 278 U. S. 339 (1929).

A. C. Bartlett created two trusts in 1903 and 1910, prior to the passage of the estate tax law. In these trusts he reserved the income to himself for life, with remainders over, and also reserved a power of revocation. He died in 1922 without having revoked either of the trusts. The 1921 Revenue Act provided, by § 402(c) that there should be included in the gross estate of a decedent all property,

> "(c) To the extent of any interest therein of which the decedent has at any time made a transfer, or with respect to which he has at any time created a trust, in contemplation of or intended to take effect in possession or enjoyment at or after his death (whether such transfer or trust is made or created before or after the passage of this Act), except * * *."

The Commissioner included the trust property in the gross estate. The tax was contested and the matter came to this Court, which sustained the Commissioner.

The opinion of the Court deals not only with the "two

trusts" mentioned, but with a quite different set of questions regarding five other trusts which were not revocable without the assent of the beneficiary and which the Court held not to be the basis for a tax.

The only ground on which the tax was opposed as to the "two trusts" was that, if applied to them, the statute would be unconstitutional because retroactive. The Court said on page 345:

> "As to the two trusts, it is argued that since they were created long before the passage of any statute imposing an estate tax the taxing statute if applied to them is unconstitutional and void, because retroactive, within the ruling of *Nichols* v. *Coolidge*, 274 U. S. 531. In that case it was held that the provisions of the similar § 402 of the 1918 Act, 40 Stat. 1097, making it applicable to trusts created before the passage of the act was in conflict with the Fifth Amendment of the federal Constitution and void, as respects transfers completed before any such statute was enacted. But in *Chase National Bank* v. *United States*, decided this day, *ante*, p. *327*, the decision is rested on the ground, earlier suggested with respect to the Fourteenth Amendment in *Saltonstall* v. *Saltonstall*, 276 U. S. 260, 271, that a transfer made subject to a power of revocation in the transferor, terminable at his death, is not complete until his death. Hence § 402, as applied to the present transfers, is not retroactive, since his death followed the passage of the statute. For that reason, stated more at length in our opinion in *Chase National Bank* v. *United States*, *supra*, we hold that the tax was rightly imposed on the transfers of the corpus of the two trusts and as to them the judgment of the court of appeals should be reversed."

Here, again, it is clear that the Court is dealing not with a question of construction but with the question of constitutionality. It is dealing with the point which is conceded in our case.

But it is argued that though the Court purported to deal with a constitutional question there must have been involved a holding that there was a transfer of property at death when the power to revoke was extinguished, because a transfer of property at death was the only thing which the statute purported to tax. That argument is unfounded. Section 402(c) of the Revenue Act of 1921, under which the case arose, does not apply in terms to transfers at death. It applies to transfers made by the decedent "at any time * * * intended to *take effect in possession or enjoyment at or after his death.*" Under that section the court was not called upon to hold that a transfer of property occurred at death when the power was extinguished. It was called upon to hold that the transfer of property which took place when the trust was created took effect in possession or enjoyment at death when the power was extinguished and the enjoyment of the income shifted.

Fourth.

Corliss v. *Bowers*, 281 U. S. 376 (1930).

This was a case under the income tax law. Corliss in 1922 created a trust to pay the income to his wife for life, with remainder over to their children. He reserved a power to revoke the trust. The Commissioner assessed a tax on

the donor under Section 219(g) of the Revenue Act of 1924. That section provided:

> "(g) Where the grantor of a trust has, at any time during the taxable year, either alone or in conjunction with any person not a beneficiary of the trust, the power to revest in himself title to any part of the corpus of the trust, then the income of such part of the trust for such taxable year shall be included in computing the net income of the grantor."

This Court sustained the action of the Commissioner. Here again the opinion contains language which taken out of context might help the Petitioner. But here again there was no question of construction. The statute clearly applied. The only question was the constitutional one. The Court said:

> "The question raised by the petitioner is whether the above section of the Revenue Act can be applied constitutionally to him * * *."

These four cases, the *Saltonstall* case, the *Chase* case, the *Reinecke* case and the *Corliss* case, are all dealing with the question of the constitutionality of clearly applicable statutes. The rule which the Court was bound to apply in those cases was that "every presumption is to be indulged in favor of the validity of the statute." The Court was not dealing with the interpretation of a tax act and was not applying the rule of strict construction in favor of the taxpayer, applicable in such cases.

Fifth.

That this is not a fanciful distinction is shown clearly in the case of *Tyler* v. *U. S.*, 281 U. S. 497 (1930), decided later than any of the four cases above referred to.

In that case the Court was dealing with the imposition of an estate tax on property subject to an estate by the entireties. It said:

> "Section 201 imposes the tax 'upon the transfer of the net estate'; *and if that section stood alone, the inclusion of such property in the gross estate of the decedent probably could not be justified by the terms of the statute.* But Section 202 definitely includes the property and brings it within the reach of the words imposing the tax; so that a basis for the constitutional challenge is present. Prior decisions of this court do not solve the problem thus presented, though what was said in *Chase National Bank* v. *United States*, 278 U. S. 327, 337-339; *Reinecke* v. *Northern Trust Co.*, 278 U. S. 339, 348; and *Saltonstall* v. *Saltonstall*, 276 U. S. 260, 271, constitutes helpful aid in that direction.
>
> Death duties rest upon the principle that death is the 'generating source' from which the authority to impose such taxes takes its being, and 'it is the power to transmit or the transmission or receipt of property by death which is the subject levied upon by all death duties.' *Knowlton* v. *Moore*, 178 U. S. 41, 56, 57. But mere names and definitions, however important as aids to understanding, do not conclude the lawmaker, who is free to ignore them and adopt his own. *Karnuth* v. *United States*, 279 U. S. 231, 242. A tax laid upon the happening of an event, as distinguished from its tangible fruits, is an indirect tax which Congress, in respect of some events not necessary now to be de-

scribed more definitely, undoubtedly may impose. If the event is death and the result which is made the occasion of the tax is the bringing into being or the enlargement of property rights, and Congress chooses to treat the tax imposed upon that result as a death duty, even though, strictly, in the absence of an expression of the legislative will, it might not thus be denominated, there is nothing in the Constitution which stands in the way.

The question here, then, is, *not* whether there has been, *in the strict sense of that word, a 'transfer' of the property* by the death of the decedent, or a receipt of it by right of succession, but whether the death has brought into being or ripened for the survivor, property rights of such character as to make appropriate the imposition of a tax upon that result (which Congress may call a transfer tax, a death duty or anything else it sees fit), to be measured, in whole or in part, by the value of such rights." (Italics ours.)

The Court says that a tax in respect of what happens on the extinguishment of the rights of a dying tenant by the entireties "probably could not be justified by the terms" of a statute simply imposing a tax "upon the *transfer* of the net estate", but that where words are added to the statute specifically to include such an occurrence the question becomes a constitutional one and that the change in the rights of the parties occurring on death, while they may not be strictly a transfer, are a bringing into being or ripening for the survivor of property rights of such character as to make appropriate the imposition of a tax. Does that not solve our problem? Are not the rights to revoke, or appoint, or change beneficiaries in the *Saltonstall*, *Chase*

and *Reinecke* cases clearly like this right of the dying tenant by the entireties?—rights on whose extinguishment a tax *"probably could not be justified by the terms of the statute"* if it simply imposed a tax upon the transfer of property, but, nevertheless, rights whose extinguishment does give rise to a change in the situation of the parties such that it *can constitutionally* be taxed by clear and appropriate language? The *Tyler* case has recently been followed. *Gwinn* v. *Commissioner,* decided by this Court Dec. 5, 1932; *Lang* v. *Commissioner,* 61 F. (2d) 280; *Hernandez* v. *Becker,* 54 F. (2d) 542.

The petitioner, on page 18 of his brief, has suggested an argument to the effect that if Congress calls a tax an estate tax it cannot make it apply to anything but transfers of property at death, and, therefore, that the *Saltonstall, Chase* and *Reinecke* cases must have involved holdings that the extinguishment of the powers in those cases resulted in transfers of property at death. That argument is unsound. The Congress can call a tax an estate tax and make its imposition or its measure depend upon transactions not amounting to transfers of property at death. This is clear from the opinion in the *Tyler* case, and from the cases which follow it, cited above on this page. It is also clear from the cases on transfers in contemplation of death. *Milliken* v. *United States,* 283 U. S. 15; *United States* v. *Wells,* 283 U. S. 102.

There is nothing in this state of the authorities to justify a retroactive abandonment of the old rule of the strict con-

struction of tax statutes or of the old law that a power was not property and that its extinguishment did not constitute a transfer of property.

General Considerations.

The real argument which we have to meet is not that this Court in the *Saltonstall, Chase, Reinecke* and *Corliss* cases was deciding a point like our own, for it patently was not.

The real argument which we have to meet is that taxation is a practical matter and should concern itself with the substance of the thing upon which the tax is imposed rather than with legal forms of expression, that the old rule of literal and strict construction of taxing acts should be abandoned as artificial and a new rule of liberal construction adopted. That is the very argument which was made and rejected in *United States* v. *Merriam,* 263 U. S. 179, at p. 187. Such a change might be justified if accomplished by statutory enactment, although it would substitute a new and vague concept for an old and very definite one in a field where certainty is of great importance. But once a rule affecting property has become established, a *retroactive* change involves elements of injustice. If the business of the world is to go on plans must be made and action must be taken on the faith of the contemporaneous law, and if we are to change that law retroactively, we may inflict a very real wrong upon those who have acted in reliance upon it. It is not a question of the fundamental logic of the rules. It is a question of the sanctity inherent in decisions which have endured for years and which have been

acted upon in good faith. If there is some public purpose to be served by the abandonment of the old rules and the old meanings of words, let the change take place by Congressional enactment (as it took place in the case of the income and estate tax laws and as it has since taken place in the gift tax law) and not by retroactive interpretation which falls like a trap upon those who have acted beyond recall.

Respectfully submitted,

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